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Creating Legitimacy for Climate Accounting in Business: Determinants of Internal Carbon Pricing

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Long Abstract

Keywords: legitimacy; corporate environmentalism; carbon accounting; internal carbon price; greenwashing.

Companies are increasingly concerned with climate change in a context of rising public awareness and of an emerging global climate governance. The legitimacy theory posits that companies use communication strategies, such as social and environmental reporting, to maintain and gain societal acceptance and influence perceptions (Welbeck et al, 2017; Unerman and Chapman, 2014; Deegan, 2002; Lindblom, 1993; Dowling and Pfeffer, 1975). Companies with low environmental performances, in particular, tend to implement larger compensation measures and disclose more environmental information to counteract potentially higher pressure from the socio-political context (Cho and Patten, 2007; Darrell and Schwartz, 1997). Following the legitimacy strategies that have been reported in the literature (e.g., Lindblom, 1993; Suchman, 1995; O'Dwyer et al., 2011), corporate climate strategies can serve as a response to conform to changes in public expectations or as an action to create new audiences and to influence societal beliefs around new practices.

Stakeholder groups comprising consumers, shareholders, experts and media have expressed concerns about climate change lately (Haque et al., 2016; Kolk and Pinkse, 2007). The attention has increased with the recent evidences about the accelerating impacts of climate change (e.g. Koldstad et al., 2014), and the potential consequences for business in terms of revenues, performances and valuation (Bianchini and Gianfrate, 2018; WBCSD, 2015). Regulatory pressures are also building with namely central bank chiefs asking for more transparency on corporate reporting of climate risks. Equity markets, along with financial regulators, are increasingly calling companies to disclose the effects of climate change in order to show their exposure to global warming risks (Bianchini and Gianfrate, 2018). However, more than simple input or output performance measures like energy consumption or GHG emissions, the relevant stakeholders need more information about the governance practices including the policies and

procedures that companies implement to manage climate change aspects of their operational activities (Haque et al., 2016).

In terms of climate mitigation in business, new practices include commensuration, i.e. turning qualitative information into a quantitative measure, and the institutionalization of emerging metrics to reduce corporate greenhouse gas (GHG) emissions (Kolk et al., 2008). Internal carbon pricing is a voluntary method for companies to internalize the social cost of their GHG emissions, even when all or part of their operations are out of the scope of external carbon regulations (WBCSD, 2015). Therefore it is important to exploit the co-creation of legitimacy for the company and for the new practices which are likely to shape the business environment in the next decades.

Companies adopt internal carbon prices in various settings and for multiple reasons (I4CE, 2016; CDP, 2016). First, the internal pricing of carbon is used for risk management purposes: as companies are increasingly exposed to regulatory and financial risks attached to the implementation of governmental carbon pricing regimes, they seek to measure, model, and manage such risks. Second, internally defined prices of carbon are featured in strategic planning activities as carbon price is an important input in the definition of the long term business model, including the identification of new strategic risks and opportunities. Third, internal carbon prices can be factored into the decisions about capital investments in relation to projects involving increases in GHG emissions, changes in the portfolio of energy sources, and reductions in emissions via energy efficiency schemes. Hence they enter as an input into scenario planning, forecasting, sensitivity analyses, and net present values estimations (WBCSD, 2015). They also allow investors to assess the extent to which companies' activities (especially from high polluting sectors) are vulnerable to increasing carbon costs. In addition to these arguments, internal carbon pricing may serve to influence how the government designs future policy and grant the company a strategic advantage. For example, it may signal to the government the momentum for the implementation of a more stringent climate policy or alternatively the no need of further regulatory action ("greenwashing").

Therefore, the paper addresses the following research questions: What drives the decision of companies to price carbon internally? What determines the set level of internal carbon prices? To what extent the adoption of internal carbon prices is associated to an actual reduction of carbon emissions? To answer the questions, we analyze the Carbon Disclosure Project—CDP reports (CDP, 2015, 2016, 2017a) containing information on the climate strategies of over a thousand global companies, among which more than a hundred disclosed their internal carbon price. Even though prices in CDP are self-reported and unaudited, large companies are compelled by stakeholders to reveal information under a reputational threat (Olivier, 2018). So

far to our knowledge no study has investigated the factors underpinning the internal adoption of higher or lower carbon prices, which could shed light on the way firms manage the transition to a low-carbon economy and the needs to maintain and gain social acceptance.